



U.S. Department of Agriculture



Office of Inspector General
Northeast Region

Audit Report

Rural Development, Rural Housing Service, Review of Rural Rental Housing Project Funds for Progressive Property Management, Inc.

Report No. 04601-02-Hy
July 2003



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Northeast Region

Suite 2-2230

5601 Sunnyside Avenue, Stop 5300

Beltsville, Maryland 20705-5300



DATE: July 22, 2003

REPLY TO

ATTN OF: 04601-02-Hy

SUBJECT: Rural Development, Rural Housing Service, Review of Rural Rental Housing Project Funds for Progressive Property Management, Inc.

TO: Jenny Phillips
State Director
Rural Development, West Virginia

Randall C. Hunt
State Director
Rural Development, Ohio

Kenneth Slone
State Director
Rural Development, Kentucky

This memorandum report presents the results of the subject audit survey. This survey was initiated because Progressive Property Management, Inc. (PPMI) improperly withdrew funds from Rural Rental Housing (RRH) projects' reserve accounts and commingled tenant security deposits with non-project funds. We verified the amount of funds taken from the accounts, the amounts repaid, and the amounts that remain to be repaid. To complete our review we visited the West Virginia Rural Development (RD) State Office to obtain background information relating to the borrower's operation and to identify the State Office concerns with the borrower and the management company. At the management company located in Columbus, Ohio, we reviewed records (i.e., bank statements and withdrawal authorizations) and interviewed management company officials.

We reviewed the security deposit accounts for 13 of the 49 RRH projects managed by PPMI and found that 12 of the project accounts were not fully funded. According to the borrower, the funds had been withdrawn from the accounts and used for project operations and non-project purposes. As a result, the security deposit accounts for 12 projects are under funded by \$54,867. In addition, the borrower used \$17,644 from project operations and loans secured by the projects to fund the security deposit accounts (see Attachment A). Accordingly, the tenants' security deposits have not been held in trust by the borrower.

We determined that the borrower and PPMI improperly withdrew \$942,167 from the reserve accounts of 22 of the 49 RRH projects managed by PPMI in West Virginia, Ohio, and Kentucky (see Attachment B). We also determined that these funds were returned to the reserve accounts.

RD is working with the borrower on a proposed settlement agreement in which the borrower will agree to return all misappropriated funds and the borrower will be excluded from property management of RRH properties.

BACKGROUND

The RRH Program is designed to provide affordable rental housing to low and moderate-income persons in rural areas by providing loans to construct RRH projects. Agency instruction 1930-C provides guidance to borrowers and management companies about the requirements for operating the projects. RD State offices and their servicing offices administer the RRH program.

As agents for the borrower, management companies are responsible for complying with all applicable laws, regulations, and loan covenants of the RRH Program. They are required to report on overall project operations by submitting annual reports to the appropriate servicing office.

In November 2001, the West Virginia RD State office notified the borrower of its intent to perform the yearend verification of account balances on ten of the borrowers' RRH accounts. The West Virginia State office Multi-family Housing Director met with the borrower in December 2001. At this meeting, the borrower admitted that he removed \$301,000 from reserve accounts to pay a judgment against another of the borrower's companies. The borrower provided a listing showing eight projects from which he had removed the funds. The listing also showed that he had returned \$146,000 to the reserve accounts. The borrower later admitted that tenant security deposits were commingled with other personal funds and not held in trust for the tenants. RD is working with the borrower on a proposed settlement agreement and concurrently reported the matter to the Office of Inspector General for review.

The borrower's management company has been a long time participant in the RRH program and currently manages 49 projects within the States of West Virginia, Ohio, and Kentucky.

OBJECTIVES

Our objectives were to verify the funds inappropriately taken from the RRH projects' reserve and security deposit accounts managed by PPMI. We also determined the amount of funds repaid and due on these accounts and assessed whether the accounts were properly maintained.

SCOPE AND METHODOLOGY

To accomplish the objectives of our review, we interviewed Rural Housing Service National office officials and West Virginia State office officials. We also interviewed officials with the borrower's management company, PPMI. We reviewed reserve account information for

all 49 projects managed by PPMI for the period December 1999 through October 2002. We reviewed the statements for these bank accounts to identify authorized and unauthorized withdrawals. The unauthorized withdrawals were discussed with the borrower and management company officials. We also identified deposits to these accounts and documented the source of the deposited funds.

We reviewed security deposit accounts for 13 of the 49 RRH projects managed by PPMI. These accounts were selected because they were subject to an annual audit by the borrower's Certified Public Accountant. We used the management company's files to evaluate the amount of security deposit funds required for each of these RRH projects as of December 31, 2001. These records included PPMI's Security Deposit Report, PPMI's RRH project tenant history file, and the RD Project Worksheet. We analyzed the bank statements for these projects to determine the current level of funding and to evaluate any withdrawals. For the deposits to the accounts, we documented the source of the deposited funds.

The fieldwork was performed between October 2002 and February 2003. We conducted the review in accordance with generally accepted government auditing standards.

AUDIT RESULTS

PPMI has not fully funded the security deposit accounts for 12 of the 13 RRH projects we reviewed. According to the borrower, the funds had been withdrawn from the accounts and used for project operations and non-project purposes. As a result, the security deposit accounts are under funded by \$54,867 and the RRH project tenants' security deposits have not been held in trust by the borrower. In addition, the borrower used \$17,644 from project operations and loans secured by the projects to fund the security deposit accounts (see Attachment A).

According to the borrower, the RRH projects have not had security deposit accounts since 1998 or 1999 when the security deposits were invested in certificates of deposit. These funds were subsequently withdrawn from the certificates of deposit and used for non-project purposes. The borrower provided no documentation, however, to support these assertions.

To determine the amount needed to fully fund the security deposit accounts PPMI used the project worksheets for each project for December 2001 to determine the resident tenants and the amount of their required security deposit. They also used a history file to determine if any tenants were long-term tenants, who would have lower security deposits. With this information, PPMI determined the required amount of security deposits as of December 31, 2001.

We concur with the management company's methodology and used it to confirm the accuracy of the security deposit required balances for 12 of the 13 projects. Using this methodology, we determined that the required balance for the remaining project, i.e., Wapak Associates, was \$9,644 as opposed to \$11,136 as determined by PPMI. In addition, we determined that security deposit accounts have not been opened for two projects, i.e., Johnstown and Wapak Associates. The following table presents the results of our review of the security deposit accounts.

A RRH Project	B State Located	C Account Opened	Source of Funds			G Required Balance	H Over/ (Short)
			D Loan Funds	E Project Operations	F Non-Project Operations		
Ansted	WV	May 10, 2002		\$200	\$0	\$4,690	(\$4,490)
Corbin	KY	August 20, 2002		\$500	\$0	\$5,270	(\$4,770)
Crab Orchard	WV	April 19, 2002		\$1,700	\$0	\$5,372	(\$3,672)
Gauley Bridge	WV	April 19, 2002		\$700	\$0	\$5,533	(\$4,833)
Godby Heights	WV	July 30, 2002		\$0	\$500	\$3,414	(\$2,914)
Happy Times	WV	April 19, 2002		\$200	\$0	\$7,303	(\$7,103)
Hurricane	WV	September 17, 2001	\$6,000	\$895	\$0	\$6,895	0
Johnstown	OH	None		\$0	\$0	\$9,090	(\$9,090)
Keyser	WV	July 1, 2001	\$5,500		\$0	\$7,252	(\$1,752)
Shinnston	WV	November 15, 2001		\$1,549	\$5,438	\$7,075	(\$88)
Switzer	WV	July 30, 2002		\$0	\$500	\$2,886	(\$2,386)
Wapak	OH	None		\$0	\$0	\$9,644	(9,644)
White Sulphur Springs	WV	April 22, 2002		\$400	\$0	\$4,525	(\$4,125)
		TOTALS	11,500	\$6,144	\$6,438	\$78,949	(\$54,867)

The borrower justified using \$6,144 from project operations to fund the security deposit accounts because he believed the projects' operating accounts had used the security deposit funds. The borrower provided no documentation to support that the security deposit funds were used in

project operations. The borrower should be required to fund the security deposit accounts with non-project funds unless he can document that the original security deposit funds were used in project operations.

We identified loans totaling \$11,500 were taken out to fund the security deposit accounts of two RRH projects. According to the borrower, the loans were to be repaid with non-project funds. However, we found that the projects (i.e., Hurricane and Keyser) were liable for repayment of the loans. The borrower should be required to revise these loans so that the RRH projects are not held liable for the repayment of the loans.

RD should analyze the borrower's determination of the amount of tenant security deposits for the remaining 36 RRH projects and ensure that these accounts are funded with non-project funds. These RRH projects are shown in Attachment C.

Recommendation No. 1:

Require the borrower to provide non-project funds totaling \$54,867 to fund the 12 RRH project tenant security deposit accounts. (This information is shown in Column H in the schedule on page 4.)

Agency Response:

By July 31, 2003, Rural Development will contact the borrower requesting non-project funds totaling \$54,867 be collected and returned to the tenant security deposit accounts of the 12 projects listed on the schedule on page 4 of the draft report. Amounts are shown in Column H.

OIG Position:

We accept RD's management decision.

Recommendation No. 2:

Require the borrower to provide non-project funds totaling \$6,144 to fund the eight RRH project tenant security deposit accounts. (This information is shown in column E in the schedule on page 4.)

Agency Response:

By July 31, 2003, Rural Development will contact the borrower requesting non-project funds listed in Column E on page 4 of the draft report totaling \$6,144 be collected and returned to the tenant security deposit accounts of the 8 projects involved in this recommendation.

OIG Position:

We accept RD's management decision.

Recommendation No. 3:

Require the borrower to revise the loans so that the Hurricane and Keyser RRH projects are not held liable for the repayment of these loans. (This information is shown in column D in the schedule on page 4.)

Agency Response:

By July 31, 2003, Rural Development will require paid-in-full notes for Keyser and Hurricane and a certification that the other partnerships are not obligated for non-Rural Development loans. The West Virginia State Office requested this information from the borrower on June 13, 2003.

OIG Position:

We accept RD's management decision.

Recommendation No. 4:

Require the borrower to provide documentation of the amount of tenant security deposits required for the remaining 36 RRH projects and require that non-project funds be used to fund the accounts.

Agency Response:

By July 31, 2003, Rural Development will require the borrower to provide documentation of the amount of tenant security deposits required for the remaining 36 RRH projects (31 in West Virginia, 2 in Kentucky, and 3 in Ohio) and require that non-project funds be used to fund the accounts. The projects are listed in Attachment B to the draft audit report.

OIG Position:

We accept RD's management decision.

Jenny Phillips, et al.

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Based on your agency's response we have reached management decision on all of the recommendations. Follow your internal agency procedures when forwarding final action correspondence to the OCFO.

We appreciate the assistance you and your staff provided to us during our review.

//S//

REBECCA ANNE BATTS
Regional Inspector General
for Audit

4 Attachments

Summary of Monetary Results

Finding No.	Description	Amount	Category
1	Security Deposit Accounts Under Funded	\$54,867	Questioned Costs Recovery Recommended
1	Project Operating Funds Used to Fund Security Deposit Accounts	\$6,144	Questioned Costs Recovery Recommended
1	Loans Used to Fund Security Deposit Accounts	\$11,500	Questioned Costs Recovery Recommended
	Total	\$72,511	

**RRH Projects with Reserve Account Funds Improperly Withdrawn
And Subsequently Returned**

<u>West Virginia</u>	<u>Reserve Funds Improperly Taken</u>
Ansted Limited	\$47,000
Cowen Elderly Limited	44,500
Craigsville II Limited	17,000
Peterstown Limited	39,000
Reddy Limited	16,500
Shady Springs Elderly Limited	111,000
Smithers Elderly Limited	35,000
Happy Times Apts. Inc.	91,000
Shinnston Limited	12,500
Craigsville Elderly	38,000
Smithers II	50,000
White Sulfur Springs Elderly	106,891
White Sulfur Springs	43,018
Pineville Limited	12,000
Lawrenceburg Limited	7,500
Guyan Terrace Limited	125,200
 <u>Ohio</u>	
Forest Associates	17,923
Greentree Apts	25,479
Johnstown Associates	18,000
Leesburg Limited	42,827
 <u>Kentucky</u>	
Belfry Limited	13,677
Corbin Limited	<u>28,152</u>
 Total funds improperly withdrawn	 \$942,167

RRH Project Security Deposit Accounts not Included in our Review

West Virginia

Barboursville Limited
Cabin Creek Limited
Cowen Elderly Limited
Craigsville Limited
Craigsville II Limited
Craigsville Elderly Limited
Elkhorn Valley Housing Authority
Giggenbach Properties Inc.
Guyan Terrace Limited
Hamlin Limited
Hinton Limited
Kenova Limited
Marlinton Limited
Marlinton Elderly Apartments
Marlinton Limited II
Mason Apartments Limited
Mountain view Limited
Mountain View III Limited
Omar Limited
Peterstown Limited

West Virginia

Shady Springs Elderly Limited
Smithers Limited
Smither II Limited
Smithers Elderly Limited
Webster Springs Limited
Webster Springs II Limited
White Oak Limited
White Sulfur Springs Elderly
Reddy Limited
Rowlesburg Limited
Pineville Limited

Kentucky

Belfry Limited
Lawrenceburg Limited

Ohio

Forest Associates
Greentree Apts
Leesburg Limited



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United States
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Rural Development

Operations and
Management

Washington, DC
20250

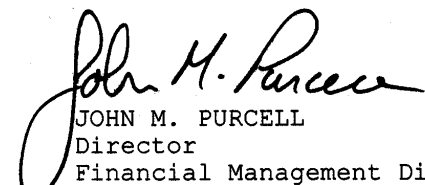
SUBJECT: Joseph S. Cozart 515 Settlement Agreement
Review of Joseph S. Cozart, Progressive Property
Management, Inc. (Audit No. 04601-002-HY)

TO: Philip T. Cole
Director
Rural Development
and Natural Resources Division
Office of Inspector General - Audit

Attached for your review is the Multi-Family Housing's response to the official draft for the subject audit.

This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendations.

If you have any questions, you may contact La'Shonda DeBrew of my staff at (202) 692-0086.


JOHN M. PURCELL
Director
Financial Management Division

Attachment



United States Department of Agriculture
Rural Development

Rural Business-Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

TO: John M. Purcell
Director
Financial Management Division

FROM: James C. Alsop *James C. Alsop*
Acting Deputy Administrator
Multi-Family Housing

SUBJECT: Audit Report 04601-002-HY
Review of Rural Rental Housing Project Funds for
Progressive Property Management, Inc.

This memorandum is submitted to respond to the subject draft report.

RECOMMENDATION NO. 1

OIG POSITION: Require the borrower to provide non-project funds totaling \$54,867 to fund the 12 RRH project tenant security deposit accounts. (This information is shown in Column H in the schedule on page 4.)

AGENCY RESPONSE:

By July 31, 2003, Rural Development will contact the borrower requesting non-project funds totaling \$54,867 be collected and returned to the tenant security deposit accounts of the 12 projects listed on the schedule on page 4 of the draft report. Amounts are shown in Column H.

RECOMMENDATION NO. 2

OIG POSITION: Require the borrower to provide non-project funds totaling \$6,144 to fund the eight RRH project tenant security accounts. (This information is shown in column E in the schedule on page 4.)

AGENCY RESPONSE:

By July 31, 2003, Rural Development will contact the borrower requesting non-project funds listed in Column E on page 4 of the draft report totaling \$6,144 be collected and returned to the tenant security deposit accounts of the 8 projects involved in this recommendation.

RECOMMENDATION NO. 3

OIG POSITION: Require the borrower to revise the loans so that the Hurricane and Keyser RRH projects are not held liable for the repayment of these loans. (This information is shown in column D in the schedule on page 4.)

AGENCY RESPONSE:

By July 31, 2003, Rural Development will require paid-in-full notes for Keyser and Hurricane and a certification that the other partnerships are not obligated for non-Rural Development loans. The West Virginia State Office requested this information from the borrower on June 13, 2003.

RECOMMENDATION NO. 4

OIG POSITION: Require the borrower to provide documentation of the amount of tenant security deposits required for the remaining 36 RRH projects and require that non-project funds be used to fund the accounts.

AGENCY RESPONSE:

By July 31, 2003, Rural Development will require the borrower to provide documentation of the amount of tenant security deposits required for the remaining 36 RRH projects (31 in West Virginia, 2 in Kentucky, and 3 in Ohio) and require that non-project funds be used to fund the accounts. The projects are listed in Attachment B to the draft audit report.

GENERAL:

The West Virginia State Office staff is working with the () to develop a settlement agreement, which will address all of the audit recommendations. They are still "pounding out" the details, and we plan to forward a copy of this agreement, once it is signed, as management decision documentation.

If you have any questions or concerns, please contact Janet Stouder, Deputy Director, Multi-Family Housing Portfolio Management Division, 720-9728; or Melba Swarey, 720-1613.